

Message Text

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ACTION AF-08

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FM AMEMBASSY ADDIS ABABA

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INFO AMCONSUL ASMARA

AMEMBASSY PARIS

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AMEMBASSY NAIROBI

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SUBJECT: ECONOMIC SIGNIFICANCE OF ETHIOPIAN CURRENCY CHANGE

REF: ADDIS ABABA 10436

1. AS REPORTED REF TEL, THE EPMG ANNOUNCED SEPT. 21 CONVERSION OF
ITS CURRENCY FROM ETHIOPIAN DOLLARS TO ETHIOPIAN BIRR. IN ADDITION T
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THE EPMG'S OBVIOUS DESIRE TO ELIMINATE HAILE SELASSIE'S PORTRAIT FROM
ITS CURRENCY NOTES, THE GOVERNEMNET ALSO HAD OTHER OBJECTIVES IN MIND

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AMONG THEM TO ELIMINATE UNCERTAINTY ABOUT THE TIMING AND CONDITIONS O
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THE INEVITABLE CHANGE IN BANK NOTES, TO REDUCE INCENTIVE FOR BLACK

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MARKET OPERATIONS AS A HEDGE AGAINST THE CHANGE IN CURRENCY

(I.E. CONVERSION OF ETHIOPIAN DOLLARS INTO HARD CURRENCIES, WHICH WOULD THEN BE CONVERTED INTO THE NEW ETHIOPIAN CURRENCY AFTER IT IS ISSUED). AND TO ELIMINATE HOARDING OF BANK NOTES, THEREBY (HOPEFULLY) ENCOURAGING THE USE OF SAVINGS ACCOUNTS WHICH IN TURN INCREASES THE AMOUNT OF FUNDS AVAILABLE FOR LENDING AND INVESTMENT.

2. THE IMMEDIATE ECONOMIC EFFECTS OF THIS CHANGE RELATE MORE TO THE SERVICE CHARGE APPLIED TO \$50, \$100 AND \$500 DENOMINATION BILLS THAN TO THE CHANGE ITSELF. FIRST, THESE DENOMINATIONS HAVE TO BE DISCOUNTED BY THE AMOUNT OF THE SERVICE CHARGE (8PERCENT FOR 50S AND 100S; 20 PERCENT FOR 500S), IF THEY ARE TO CONTINUE IN USE DURING THE INTERIM PERIOD, I.E. SEPT 21 UNTIL THEY CAN BE EXCHANGED FOR NEW BIRR NOTES ON OCTOBER 14. THIS COULD CAUSE CONSIDERABLE CONFUSUION AND A PREFERENCE FOR 20S, 10S, AND 5S AND 1S TO WHICH NO SERVICE CHARGE IS TO BE APPLIED WHICH MAY WELL RESULT IN A TEMPORARY SHORTAGE OF THESE BILLS. IT IS DIFFICULT TO UNDERSTAND WHY THE EPMG ANNOUNCED THE CONVERSION AND SERVICE CHARGE SO FAR IN ADVANCE OF THEIR ABILITY TO CARRY OUT THE CONVERSION POSSIBLY THE GOVERNMENT FEARED THAT ITS INTENTIONS WOULD LEAK TO THE PUBLIC. IN ANY CASE, THE MONETIZED SECTOR OF THE ETHIOPIAN ECONOMY FACES A DIFFICULT THREE WEEKS.

3. SECOND, WHY WAS A SERVICE CHARGE INPOSED? THE GOVERNMENT CLAIMS THAT IT IS TO COVER THE COST OF CONVERSION WHICH MUST BE BORNE BY THE PUBLIC ON THE GROUNDS THAT THE PUBLIC USES THE NOTES. GIVEN THIS BASIC PROPOSTIION THE GOVERNMENT DECIDED AS A MATTER OF CONVENIENCE AND EQUITY THAT ONLY DENOMINATIONS OF HIGHER VALUES SHOULD BEAR THE SERVICE CHARGE. ACCORDING TO NATIONAL BANK DATA THE TOTAL CURRENCY IN CIRCULATION WAS ROUGHLY 800 MILLION DOLLARS AS OF AUGUST 31. OF THIS AROUND \$380 MILLION OR 47PERCENT OF TOTAL CURRENCY WAS DENOMINATED IN 50S, 100S, AND 500S AS FOLLOWS:

FIFTY DOLLAR BILLS \$75 MILLION

ONE HUNDRED DOLLAR BILLS \$305 MILLION

FIVE HUNDRED DOLLAR BILLS \$500 THOUSAND

IF ALL OF THE BILLS ARE REDEEMED THE TOTAL SERVICE CHARGEYIELD WOULD BE APPROXIMATELY \$30 MILLION DOLLARS. WHILE THE EMBASSY HAS NO WAY OF ASCERTAINING THE COST OF THE NEW CURRENCY \$30 MILLION DOES NOT SEEM UNREASONABLE. IN ANY CASE IT DOES NOT REPRESENT A LARGE WINDFALL FOR THE GOVERNMENT. CONSEQUENTLY, THE EMBASSY BELIVES THE OFFICIAL REASON JUSTIFYING THE SERVICE CHARGE IS LIMITED OFFICIAL USE

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PROBABLY THE REAL REASON.

4. ASIDE FROM THE EFFECTS DESCRIBED ABOVE, THE ECONOMIC IMPACT OF THE CONVERSION SHOULD BE MINIMAL, ALTHOUGH TO THE EXTENT NOTES ARE NOT REDEEMED THE MONEY SUPPLY WILL BE REDUCED, THEREBY HELPING TO RELIEVE INFLATIONARY PRESSURES, IF ONLY marginally. IT IS ALSO INTERESTING TO NOTE THAT AT LEAST SO FAR THE EPMG APPARENTLY HAS NO INTENTION OF USING CONVERSON AS A MEANS OF CATCHING TAX EVADERS

AS HAS BEEN DONE IN OTHER COUNTRIES. AS EPT IS AWARE THE MOFA HAS TOLD DIPLOMATIC CORPS THAT IT WILL OPEN POUCHES (SEE SEPTTEL). MANY DIPLOMATS, REMEMBERING THE NIGERIA EPISODE (NIGERIA INSISTED ON EXAMINING DIPLOMATIC POUCHES AT THE TIME GON CHALKID ITS CURRENCY) BELIEVE THE EPMG IS TRYING TO PREVENT CURRENCY ILLEGALLY TAKEN FROM THE COUNTRY FROM BEING RETURNED THROUGH DIPLOMATIC POUCHES FOR EXCHANGE TO BIRRS. EMBASSY IS DOUBTFUL, HOWEVER, THAT MUCH ETHIOPIAN CURRENCY HAS BEEN SMUGGLED OUT OF THE COUNTRY, OR THAT EMBASSIES WOULD TRY TO BRING CURRENCY BACK IN FOR CONVERSION ON BEHALF OF ITS NATIONALS.

5. THE EFFECT OF CONVERSION ON EMBASSY OPERATIONS AND OFFICIAL PERSONNEL DISCUSSED SEPTTEL.
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